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SUBJECT: LEBANON: PARIS III RESULTS PHENOMENAL, BUT LOTS
OF WORK TO DO

Classified By: Ambassador Jeffrey Feltman for reasons 1.4 (b) and (d)

SUMMARY

11. (C) Ministers Jihad Azour and Sami Haddad, clearly excited by the successful outcome of the Paris III Donor's Conference, want to make sure that the money pledged will be tied to reforms and spent with discipline. Chatting about the event, they are ready to tackle banking reform and to take advantage of a market upswing. They hope to direct donors to the areas with the most beneficial financial impact, and they are open to suggestions for next steps. End summary.

PARIS PLEDGES ARE BETTER THAN EXPECTED

12. (C) In a meeting at the Grand Serail on 1/31 the Ambassador and Econoff met with Ministers Jihad Azour (Finance) and Sami Haddad (Economy and Trade) for a readout on the results of Paris III. Both Azour and Haddad were extremely pleased with the results, and thanked the Ambassador for the strong USG support. Azour pointed out that the amount pledged, more than USD 7.6 billion, was in the range that the GOL had been hoping for, but was unwilling to specify in advance. Azour also commented that the USG promise of an additional USD 770 million "as a ratio of (the Lebanese) GDP was phenomenal." There will be a lot more work required understanding the details of each pledge, and both were eager to clarify the breakdown of the proposed US donation, which they realize is not yet approved by Congress.

PARIS III SOUND BITES

13. (C) In a brief critique of the events in Paris, Azour and Haddad said they had spent the day prior to the event "fine-tuning." Disappointed that Qatar and Kuwait did not pledge additional assistance, Azour said that the Kuwait delegation said later that they would be making additional contributions. Chirac was admired for his grasp of all the details, and his ability to secure pledges from reluctant donors. The meeting between Prime Minister Sinora and Secretary Rice did not receive enough media coverage, in

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their view, but they were pleased with the high visibility of the private sector support, especially the CEOs of the US-Lebanon Partnership Fund, and Nissan CEO Carlos Ghosn, who later, at Davos, met with John Chambers of Cisco.

BANKING AND FINANCIAL SECTOR
HAS A JOB TO DO

13. (C) The team under Azour, who worked to develop the detailed reform plan for the conference, will immediately turn its attention to the questions around implementation of the program. How much Azour will be able to change the Lebanese cult of corruption, cronyism and complacency is unclear, but he is moving fast in his attempts. He had a meeting scheduled that afternoon to discuss efforts to insure the positive participation of the banking and financial sector in the reform program; that is the one missing piece. Acknowledging that the banking sector needs to "clean up the mess" and insure its financial independence from the government, he pointed out that legislation has been sent to Parliament to do just that. But Azour appears confident that the Central Bank will step up and make the necessary changes, and would not discuss rumors of corruption, saying that "these are colleagues."

STRIKE WHILE THE MARKET IS HOT

14. (C) One motivating factor in Azour's desire to move quickly is the fickle attitude of the marketplace. Following Paris III, Standard and Poor's have already changed their rating of Lebanon to positive. Azour intends to talk to the other rating agencies to see if he can get them to move up as well. This will help the GOL in more than just reducing the cost of future debt. It will also have a very positive impact on the value of the concerns that Azour hopes to privatize -- telecommunications, Electricite du Liban (EDL), and others. He hopes to accelerate privatization while the market is receptive. The general financial "good will" leads

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to added liquidity in the private sector as well, which will increase the perceived value of the concerns he hopes to sell.

ROLL OVER DEBT, BUT
DISCIPLINE SPENDING

15. (C) Debt restructuring is an obvious concern, with a number of loans coming due in 2007. Obviously rolling over debt will be easier and less costly if the market is positive; in fact, it will be very easy and even easier if the privatization goes quickly. Paying down debt and meeting interest obligations is clearly one focus of Azour, and he, like Haddad, is very interested in understanding the breakdown of the Paris III pledges and what will be available for that purpose. But both agreed that if the result of Paris III is, in effect, just "bridge financing" then there will continue to be problems. Azour is eager to impose "discipline" on the spending of the GOL and its various agencies. For example, he pointed out that the LAF has recruited 15,000 more soldiers in the past year, which represents the equivalent of the entire civil service. There are 250 generals alone. Over 90 percent of the budget of the LAF goes to recurring expenses, largely salaries and benefits. Additional donations of equipment and supplies, if they were not replacements for budget items, will only increase costs. The LAF needs to find ways to operate more efficiently, with less manpower.

GIFTS SHOULD REDUCE DEBT,
NOT INCREASE IT

16. (C) The army is not the only agency with this problem; for this reason Azour is determined to scrutinize the promised donations, to attempt to tie as many as possible to existing budget items. Non-debt related donations should all have a positive impact on the national finances. He believes

that there should be a meeting of donor countries to discuss the promised contributions and to tie them in so far as possible to the GOL budget and the proposed social safety net; who will cover or replace budget line items? In keeping with this Azour is determined to tie the donations to reforms. To do this will require both discussion, and meetings to establish benchmarks. To this end he suggested the need for a meeting convening those who made pledges, like the meeting to plan Paris III, where donors would agree on the allocation of financial responsibilities and reform goals.

NEXT STEPS

17. (C) The anticipated cost of the social safety net described by Azour's team would cost between USD 75-200 million per year. This is a key program, as is, of course, reducing the deficit attributable to the EDL. Azour asked the Ambassador to find out who from the US side would be available to coordinate the post-conference details. He and Haddad also asked if they should begin to lobby in Washington to secure the approval by Congress of the USD 770 million donation by the USG. Clearly buoyed up by Paris III, they are anxious to get the new programs started, possibly in the hopes that they will continue despite any potential change in regime.

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